No. 11643

In the United States Circuit Court of Appeals for the Ninth Circuit

Bloomfield Ranch, by James A. Clayton & Co., a Corporation, Managing Partner, Operator and Co-owner Thereof, and by Florence G. Baldwin, John Derrol Chace, Willis Sherman Clayton, Jr., Arthur D. Curtner, John Kirk Dorrence, Rose L. Fitch, Margaret F. Coykendall, Hugh S. Hersman, Alfred A. Hapgood, George H. Osen, Alfred L. Parkinson, Estate of Andrew R. Patrick, Deceased, by Sigurd C. P. Cornett, as Executor of the Will of Andrew R. Patrick, Deceased, San Jose Hardware Co., a Corporation, Nellie Shillingsburg, Anne Thompson, Sarah Shillingsburg Barry, Margaret Leaman, and Estate of Ellen Weinstein, Deceased, by Wells Fargo Bank & Union Trust Co., Executor, Substituted for Estate of Samuel Weinstein, Deceased, by Ellen Weinstein, as Executrix of the Will of Samuel Weinstein, Deceased, Partners in and Co-owners of Bloomfield Ranch, petitioners

v.

Commissioner of Internal Revenue, respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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CITATIONS

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OPINION BELOW

The memorandum opinion of the Tax Court (R. 212–227) is not reported.

JURISDICTION

This petition for review (R. 239–241) involves federal income and declared value excess profits taxes for the taxable year 1940. On February 28, 1944, the Commissioner of Internal Revenue mailed to the taxpayer notice of deficiency in the total amount of $10,806.18. (R. 19–22.) Within ninety days thereafter and on May 22, 1944, the taxpayer filed a petition with the Tax Court for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. (R. 6–22.) The decision of the Tax Court sustaining the deficiency was entered January 31, 1947. (R. 227–228.) The case is brought to this Court by a petition for review filed April 21, 1947 (R. 239–241), pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTION PRESENTED

Whether the Tax Court erred in sustaining the Commissioner's determination that taxpayer is an association taxable as a corporation under Section 3797 (a) (3) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra.*

STATEMENT

The facts as stipulated (R. 202–211) and found by the Tax Court (R. 212–219) may be summarized as follows:

In 1926 James A. Clayton & Company (hereafter called "Clayton Company"), a real estate agent, in-

duced 13 of its customers to join with it in the purchase of 21 separate parcels of California land from its then owner, Miller & Lux, Inc. The parcels were widely scattered in 3 counties, contained about 27,500 acres suitable for various agricultural purposes, and also contained 42 acres of city property. Miller & Lux, Inc. had operated the properties as one going concern for raising cattle and feed and for conducting some farming operations, employing at times as many as 200 men. Clayton Company and the 13 individuals who joined with it each invested $50,000 (a total of $700,000) and formed a syndicate known as Bloomfield Ranch, hereafter referred to as "taxpayer".[1] The agreement of the parties was represented by 14 separate but identical written instruments signed by Clayton Company as "Operator" and by each participant as "Investor". (R. 212–214.) After acknowledging receipt of $50,000 by the Operator from the Investor, the agreement (incorporated by reference in the Tax Court's findings (R. 214)) provided as follows (R. 167–170):

> The Operator is to use said sum, together with other sums contributed by thirteen other persons, who are also referred to herein as "Investors" and other sums borrowed or advanced by said Operator—the unpaid portions thereof, may be re-borrowed or renewed, and security given—in the purchase of certain lands and interests, in the counties of Santa

[1] While Bloomfield Ranch is referred to as "taxpayer", the petitioners in this proceeding are its 19 outstanding members. It filed a partnership return for the taxable year (R. 190), in which the members were described as partners (R. 194).

Clara, San Benito and Santa Cruz, California, belonging to Miller & Lux, Inc., and consisting of approximately 27,000 acres of land, together with divers rights, appurtenances and easements as described in three deeds to M. E. Thomas dated March 3rd, 1926, and recorded March 10th, 1926, in Santa Clara, San Benito and Santa Cruz Counties, Cal.

The Operator is to take and hold title to said properties originally in the name of M. E. Thomas; but may take such title in the name of any other person, corporation or concern, or in its own name; and may have such title conveyed, from time to time, to other persons, corporations or concerns, or otherwise conveyed or held, as the Operator may desire, in trust for the said 14 investors above referred to, for the profitable resale thereof.

The Operator may sell, convey, hold, lease for one season only, or in any otherwise deal with and treat said properties as the sole and absolute owner thereof in fee simple, and without let or hindrance from the Investor, or any of the Investors, less than the full number thereof, or any other person or concern, whatsoever. But may not exchange, encumber, nor lease except as above specified, nor sell trees, wood or improvements off from said property without the consent of the investors.

The Operator may, from time to time, incur such costs, expenses, and charges in connection with the acquiring, holding, renting, selling or protecting of said properties, as it may deem proper; and the fact of the Operator incurring such cost, expense or charge, shall conclusively establish the propriety and legality thereof.

The Operator shall keep true and accurate books of account, in which shall be set down, from time to time, all moneys paid out and charges, expenses and costs incurred in the premises, and all sales made and properties disposed of, and moneys or other things of value received by it in the premises.

Out of the moneys received from sales or renting or other sources of said properties, the Operator shall first retain for its own use and benefit, a commission of five per centum (5%) on the gross selling price of each parcel sold, as sales are made, and from the net proceeds of such sales, after deduction of its commissions, the Operator shall pay all costs, expenses, and charges paid or incurred by it in the premises, and all moneys advanced or borrowed by it, together with interest thereon.

From any residue of moneys remaining in the Operator's hands, after all the foregoing payments have been made, the Investor shall be entitled to have returned to him, at the same time, and in equal amounts, as are returned to the other Investors, the whole or such part of the said sum herein receipted for, as may, in the judgment of the Operator, be safely paid, without jeopardy to any remaining properties or assets, not yet converted into cash; but no Investor shall be entitled, as of right, to any payment or return, or repayment before said properties and the proceeds thereof, have been converted into cash, and all such commissions, debts, advances, costs, charges and expenses have been fully paid, provided, however, that upon the payment of the debts, taxes and charges accrued, such funds shall be distributed equally

to said Investors whenever there shall be a net amount of $7000 or more on hand.

When, as, and if all of said properties, and all properties, and all proceeds therefrom shall have been sold and converted into cash, and all such commissions, debts, advances, costs, charges and expenses shall have been fully paid, and all moneys advanced by the Investors shall have been fully repaid, all moneys, if any, then remaining in the hands of the Operator arising out of said transactions, and not applicable to any of the foregoing requirements, shall be, by said Operator, paid to and divided among the Investors, in equal shares to each of them, their heirs and assigns.

It is authorized, understood and agreed, however, that the Operator has charged, and is entitled to a commission of Fifty Thousand ($50,000.00) Dollars for the negotiation, purchase and consummation of sale of said properties from Miller & Lux, Inc., to said M. E. Thomas, which is in addition to commissions to be credited to it for subsequent resales, and which shall be added to, and included in charges and expenses of the transactions herein provided for, and accounted as part of the original purchase price of said properties.

The Investor shall be entitled to have an account rendered to him by the Operator, of all transactions hereunder, on demand, but not more often than once each sixty days.

These presents are executed in duplicate by the Operator and the Investor, the day and year set out at the opening hereof, and shall be binding upon the successors, heirs, representatives and assigns of each of them.

In March of 1926 Clayton Company paid Miller & Lux, Inc. $1,235,000 for the properties. It borrowed $585,000 which, with the $700,000 contributed by the Investors, covered the purchase price plus its commission of $50,000. Titles were taken in the name of one Thomas, an employee. (R. 216.) The properties were purchased subject to outstanding leases which had been made by Miller & Lux, Inc., and the rentals from these leases amounted to $34,041 in 1926. (R. 216.) Miller & Lux had installed 9 wells and pumping units on the properties, and Clayton Company installed some new ones and repaired the old ones at a total cost of $37,903. (R. 218–219.)

From 1926 through the taxable year (1940) the operations of Clayton Company consisted of farming, renting, and selling the properties; collecting rents and payments of principal and interest on installment sales; paying taxes; disposing of its farm products; and in general attending to financial and accounting aspects of the venture. (R. 218.) From the beginning it adopted a policy of renting parcels under one-year leases subject to renewal, and of keeping some of the acreage under cultivation in wheat and barley until parcels were sold; this was done both to carry taxes and keep the properties from going "native". (R. 217.) From 1926 through 1930, 90% of the properties had been sold, and by the end of 1927 Clayton Company had repaid the $585,000 it had borrowed as part of the purchase price of the properties. After 1930 sales dropped sharply due to the depression, and only 60 acres were sold in the next 10 years. There was never any intention to subdivide the 42 acres of

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city property into lots, and Clayton Company refused to sell this acreage in units of less than one city block. (R. 216–217.) During the fifteen-year period from 1926 through 1940 interest received totalled $156,-402.85, profits from sales totalled $311,766.93; gross rentals totalled $456,062.91; and miscellaneous receipts totalled $19,533.97. Total gain over the cost of the properties amounted to $541,843.06. (R. 218.) Income from farming and rent was accounted for separately on tax returns; with the exception of 3 years the farming operations were conducted at a loss. (R. 217–218.)

Distributions totaling $98,250 have been made on each of the 14 investment units, or a total of $1,375,500. This represents a return of the original $700,000 capital invested in the enterprise plus profits from all operations. (R. 218.)

Changes have occurred in ownership of the Investors' interests due to deaths, transfers and sales of all or a part of the original 14 investor units. There are now 19 Investors holding the original 14 interests, some holding less and others holding more than a $\frac{1}{14}$ interest. Whenever any change in Investor interests occurred Clayton Company was notified and made formal acknowledgement and record of the change. The original agreement of each Investor had attached to it endorsement of any transfer. (R. 219.)

Taxpayer reported its income for the taxable year as a partnership. (R. 190, 212.) The Commissioner determined that the enterprise was an "association" taxable as a corporation under Section 3797 (a) (3) of the Internal Revenue Code, resulting in the de-

ficiencies in controversy. (R. 21–22.) The Tax Court sustained this determination. (R. 219, 227–228.)

SUMMARY OF ARGUMENT

Under principles established by the Supreme Court, embodied in the long-standing Regulations, and consistently applied by this Court and other Circuit Courts of Appeals, the Tax Court was clearly justified in classifying taxpayer as an "association" taxable as a corporation. Taxpayer was organized for business purposes by a group of "Investors" who jointly contributed capital to the enterprise and received the profits in proportion to their participating interests. With the possible exception of one feature (limited liability) whose absence is not decisive, the organization possessed the salient features of a conventional corporation: centralized management, continuity of existence, and transferability of the interests of the participants. Taxpayer's contention that it was merely a liquidating trust disregards the terms of the agreement under which it was organized as well as the uncontroverted facts, and is also incompatible with its simultaneous insistence that it was a partnership for tax purposes. The cases upon which it relies are not comparable and do not warrant reversal of the decision below.

ARGUMENT

The Tax Court correctly held that taxpayer is an association taxable as a corporation under Section 3797 (a) (3) of the Internal Revenue Code

Taxpayer reported its income for the taxable year as a partnership. (R. 190.) Its current members

(the petitioners herein) are described as partners in the return (R. 194), and so represent themselves in this proceeding (R. 2, 212). The Tax Court, sustaining the Commissioner's determination, concluded that taxpayer was an "association" taxable as a corporation under Section 3797 (a) (3) of the Internal Revenue Code (Appendix, *infra*). (R. 219, 227.) We submit that the Tax Court's conclusion is not only warranted but demanded by the record.

The Internal Revenue Code makes its own classification of business enterprises for federal income tax purposes.[2] Section 3797 (a) (2) (Appendix, *infra*) defines a partnership as including any joint venture or other unincorporated organization "which is not, within the meaning of this title, a trust or estate or a corporation". Section 3797 (a) (3) in turn defines a corporation as including "associations". The principles determinative of whether an unincorporated organization is an association, and hence to be treated as a corporation for tax purposes, were laid down by the Supreme Court in *Morrissey* v. *Commissioner,* 296 U. S. 344, and the companion cases of *Swanson* v. *Commissioner,* 296 U. S. 362, *Helvering* v. *Combs,* 296 U. S. 365, and *Helvering* v. *Coleman-Gilbert,* 296 U. S. 369. These principles are embodied in the longstanding applicable Treasury Regulations (Sections 19.3797–1 to 19.3797–5 of Treasury Regulations 103

[2] Taxpayer's reliance upon state law (Br. 22–25, 32, 34–35) is misplaced. *Burk-Waggoner Assn.* v. *Hopkins*, 269 U. S. 110; *Morrissey* v. *Commissioner*, 296 U. S. 344; *United States* v. *Homecrest Tract*, 160 F. 2d 150 (C. C. A. 9th); *Coast Carton Co.* v. *Commissioner*, 149 F. 2d 739 (C. C. A. 9th); *Sherman* v. *Commissioner*, 146 F. 2d 219 (C. C. A. 6th).

(Appendix, *infra*)), which set forth the tests to be applied and the factors to be weighed in ascertaining whether an organization is an association, a trust, or a partnership for tax purposes. Since the statutory provisions to which these Regulations are addressed have been repeatedly reenacted by Congress, they must be deemed to have received implied legislative approval. *Coast Carton Co.* v. *Commissioner,* 149 F. 2d 739, 741 (C. C. A. 9th); *Commissioner* v. *Security-First Nat. Bank,* 148 F. 2d 937, 940 (C. C. A. 9th); *Sherman* v. *Commissioner,* 146 F. 2d 219 (C. C. A. 6th).

This Court [3] and other Circuit Courts of Appeals [4] have had frequent occasion to deal with the question

[3] *United States* v. *Homecrest Tract, supra; Commissioner* v. *Security-First Nat. Bank, supra; Helm & Smith Syndicate* v. *Commissioner*, 136 F. 2d 440; *Lombard Trustees* v. *Commissioner*, 136 F. 2d 22; *Porter* v. *Commissioner*, 130 F. 2d 276; *Kettleman Hills R. S. No. 1* v. *Commissioner*, 116 F. 2d 382, certiorari denied, 313 U. S. 582; *Jackson* v. *United States*, 110 F. 2d 574; *United States* v. *Trust No. B. I. 35, Etc.*, 107 F. 2d 22; *Title Insurance & Trust Co.* v. *Commissioner*, 100 F. 2d 482; *Thrash Lease Trust* v. *Commissioner*, 99 F. 2d 925, certiorari denied, 306 U. S. 654; *Commissioner* v. *Vandegrift R. & Inv. Co.*, 82 F. 2d 387; *Coast Carton Co.* v. *Commissioner, supra; Commissioner* v. *Gerstle*, 95 F. 2d 587.

[4] See, *e. g.*, *Wabash Oil & Gas Ass'n* v. *Commissioner*, 160 F. 2d 658 (C. C. A. 1st), certiorari denied, June 9, 1947; *Bordages Estate Trust* v. *Commissioner*, 159 F. 2d 62 (C. C. A. 5th); *Fletcher* v. *Clark*, 150 F. 2d 239 (C. C. A. 10th), certiorari denied, 326 U. S. 763; *Poplar Bluff Printing Co.* v. *Commissioner*, 149 F. 2d 1016 (C. C. A. 8th); *Sherman* v. *Commissioner*, 146 F. 2d 219 (C. C. A. 6th); *National Metropolitan Bank* v. *Commissioner*, 145 F. 2d 649 (C. C. A. 4th); *Adkins Properties* v. *Commissioner*, 143 F. 2d 380 (C. C. A. 5th); *Commissioner* v. *City Nat. Bank & T. Co.*, 142 F. 2d 771 (C. C. A. 10th), certiorari denied, 323 U. S. 764; *United States* v. *Hill*, 142 F. 2d 622 (C. C. A. 10th); *Pennsylvania Co. for Insurance, Etc.* v. *Uniter States*, 138 F. 2d 869 (C. C. A.

here presented, and no useful purpose would be served by an elaborate survey of the applicable principles and the legion of cases in this field. Suffice to reiterate, as the Regulations provide and the cases uniformly hold, that any association of persons organized for the purpose of sharing the profits of a business venture and possessing organizational advantages of a conventional corporation is an "association" taxable as a corporation, irrespective of the forms employed or the label placed upon the organization by the parties. "The inclusion of associations with corporations implies resemblance; but it is resemblance and not identity". *Morrissey* v. *Commissioner, supra,*

2d), certiorari denied, 321 U. S. 788; *Sibley Syndicate* v. *Commissioner*, 131 F. 2d 224 (C. C. A. 6th), certiorari denied, 318 U. S. 786; *Keating-Snyder Trust* v. *Commissioner*, 126 F. 2d 860 (C. C. A. 5th); *Commissioner* v. *Nebo Oil Co., Trust*, 126 F. 2d 148 (C. C. A. 10th), certiorari denied, 317 U. S. 636; *Second Carey Trust* v. *Helvering*, 126 F. 2d 526 (App. D. C.), certiorari denied, 317 U. S. 642; *Commissioner* v. *Fortney Oil Co., Etc.*, 125 F. 2d 995 (C. C. A. 6th); *Nashville Trust Co.* v. *Cotros*, 120 F. 2d 157 (C. C. A. 6th), amended, 122 F. 2d 326, certiorari denied, 314 U. S. 680; *Fidelity-Bankers Trust Co.* v. *Helvering*, 113 F. 2d 14 (App. D. C.), certiorari denied, 310 U. S. 649; *Del Mar Addition* v. *Commissioner*, 113 F. 2d 410 (C. C. A. 5th); *Sears* v. *Hassett*, 111 F. 2d 931 (C. C. A. 1st); *Marshall's Heirs* v. *Commissioner*, 111 F. 2d 935 (C. C. A. 3d), certiorari denied, 311 U. S. 658; *Hamilton Depositors Corp.* v. *Nicholas*, 111 F. 2d 385 (C. C. A. 10th); *Ross Lewis Trust* v. *Commissioner*, 110 F. 2d 937 (C. C. A. 10th); *Wellston Hills Syndicate Fund* v. *Commissioner*, 101 F. 2d 924 (C. C. A. 5th); *Kilgallon* v. *Commissioner*, 96 F. 2d 337 (C. C. A. 7th), certiorari denied, 305 U. S. 622; *Bert* v. *Helvering*, 92 F. 2d 491 (App. D. C.); *United States* v. *Rayburn*, 91 F. 2d 162 (C. C. A. 8th); *Solomon* v. *Commissioner*, 89 F. 2d 569 (C. C. A. 5th), certiorari denied, 302 U. S. 692; *Brooklyn Trust Co.* v. *Commissioner*, 80 F. 2d 865 (C. C. A. 2d), certiorari denied, 298 U. S. 659; cf. *Titus* v. *United States*, 150 F. 2d 508 (C. C. A. 10th).

p. 357. And whether the organization is sufficiently analogous to a corporation to justify taxation of its income as such depends on whether it possesses some or all of the following salient features: (1) centralized management; (2) continuity of title; (3) continuity of existence, uninterrupted by the death of a participant; (4) transferability of the interests of the participants; and (5) limited personal liability of the participants. With respect to "partnerships" vis-a-vis "associations", the Regulations provide, *inter alia* (Section 19.3797–4):

> On the other hand the Code classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or more persons in their representative capacities, such an organization is an association, taxable as a corporation.

The instant organization was created by an agreement between the "Operator" (Clayton Company) and 14 "Investors". (R. 167–170, 213–214.) When it is tested by the established criteria there can be no doubt that the Tax Court was warranted in concluding that it was an association, not a partnership or trust. With the possible exception of the limited liability feature—whose absence would not be controlling anyway [5]—the

[5] As the Tax Court observed (R. 226–227), it is not clear from the agreement whether liability of the Investors to third parties was limited, although it would seem so. In any event, "limitation of the beneficiary's liability is not a sine qua non of the corporate

organization possessed all the salient features of a conventional corporation. (1) Management of the enterprise was unquestionably centralized in the Operator. (R. 167–168, 217–218.) (2) Continuity of title was assured by the provisions authorizing the Operator to take title in the name of its employee, Thomas, or "in the name of any other person, corporation or concern, or in its own name." (R. 167, 216, 224.) [6] (3) Continuity of the enterprise was not interrupted by the death of any Investor; the profits were to be divided among them or their "heirs and assigns", and the agreement was binding on the "successors, heirs, representatives and assigns" of each Investor. (R. 170.) (4) The interests of the 14 original Investors were transferable and have been transferred in whole or in part by death, sale or assignment; in each instance the Operator made formal acknowledgment and record of the transfer, and there are now 19 Investors (the petitioners herein) holding varying portions of the original 14 Investor interests. (R. 171–186, 219.)

If we understand taxpayer's extended argument correctly, its chief contention is that the Investors

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analogy". *Helm & Smith Syndicate* v. *Commissioner*, *supra*, p. 441. See also *Burk-Waggoner Assn.* v. *Hopkins*, *supra*; *Del Mar Addition* v. *Commissioner*, *supra*, p. 411; *Bert* v. *Helvering*, *supra*, p. 495; *Pennsylvania Co. for Insurances, Etc.* v. *United States*, *supra*, p. 874; *Fletcher* v. *Clark*, *supra*. Section 19.3797–4 of Treasury Regulations 103.

[6] Cf. *United States* v. *Homecrest Tract*, *supra*, fn. 8, p. 153; *Wabash Oil & Gas Ass'n* v. *Commissioner*, *supra*; *Wellston Hills Syndicate Fund* v. *Commissioner*, *supra*. The Operator was also authorized to convey the title to others in trust for the Investors (R. 167–168); it never did so, but kept the title in its employee Thomas (R. 224).

did not associate themselves in a profit-seeking enterprise, but merely created separate liquidating trusts of which the Operator's employee (Thomas) was trustee and the Operator was manager. (Br. 17–18, 38–45.) The contention is patently untenable; it disregards the plain tenor of the agreement between the Operator and the Investors, the uncontroverted facts, the applicable Regulations, and the controlling decisions.

To begin with, taxpayer's claim that the Investors acted "individually and separately" (Br. 17) is irreconcilable with its simultaneous insistence that they were "joint venturers" (Br. 17, 18) and acted as a "group" (Br. 20, 21), to say nothing of the fact that taxpayer reported its taxable income as a partnership (R. 190) and still urges that it is a partnership (Br. 17, 19–20, 28). The contention rests upon the gratuitous assumption (Br. 38, 41) that, because the 14 original Investors signed separate (but admittedly identical) instruments of agreement with the Operator, they cannot be regarded as "associates". Surely the fact that the Investors affixed their signatures to several identical documents, rather than to one document, does not preclude the inference that they "joined in a common enterprise" and "became associated in the enterprise according to the terms of the arrangement". *Helvering* v. *Combs, supra,* p. 368. Unless sheer form is to prevail over substance, the Tax Court's finding (R. 213–214, 222–223) that the agreement of the parties was contained in the 14 identical instruments of agreement is inescapable. Not only were the instruments identical except for the

names of the subscribing Investors, but it is manifest from their identical provisions that the Investors were jointly investing capital in a common enterprise with a view to sharing its profits. For example, the Operator was to use the sum contributed by each Investor "together with other sums contributed by thirteen other persons, who are also referred to herein as 'Investors' ", to purchase the properties (R. 167) ; it could sell, hold, or "in any otherwise deal with" the properties as it saw fit without interference by any of the Investors "less than the full number thereof" (R. 168) ;[7] and each Investor was entitled to a return of net profits "at the same time, and in equal amounts, as are returned to the other Investors" (R. 168–169). It is immaterial whether, as taxpayer claims (Br. 38), the Investors neither met nor knew each other before entering into the arrangement; granting this be so, it no more prevents treatment of the organization as an association taxable like a corporation than would the fact that stockholders independently subscribe to stock bar taxability of their organization as a conventional corporation. "Undoubtedly the terms of an association may make the taking or acquiring of shares or interests sufficient to constitute participation, and may leave the management, or even control of the enterprise, to designated persons". *Morrissey* v. *Commissioner, supra,* p. 357. In *Wellston Hills Syndicate Fund* v. *Commissioner,* 101 F. 2d 924 (C. C. A. 8th),

[7] Even if the Investors retained no control over the Operator they could be deemed "associates". *Helvering* v. *Combs, supra; Helvering* v. *Coleman-Gilbert, supra.*

the court stated with respect to the syndicate there involved (p. 927):

> Is this an "association" within the revenue statute as that term is defined in the *Morrissey* case, *supra*? Clearly these parties were associaated together. The contract brought their money together and defined the rights of the parties. It created a fund, set forth the uses thereof, the party solely entitled to direct usage thereof, the interests of the various parties and the disposition of the fund. Also, this association of individuals was for a business undertaking. The sole inducement for participation was the hope of making money through the acquisition, improvement and sale of a tract of land. Thus the petitioner met the requirements of an association in the respects that it brought together various individuals in a common enterprise for business purposes.

Equally without merit is taxpayer's related contention (Br. 17, 23–26) that the Investors each created a trust of which Thomas was trustee. The parties did not even purport to create a trust, and the Tax Court properly refused to find that they did. (R. 224.) Admittedly (Br. 20) title was taken in Thomas' name for "convenience." As is plain from the agreement (R. 167–168) Thomas was simply a depositary of the title; all powers were vested in the Operator. Significantly, no income tax return was filed by Thomas (or for that matter, by the Operator) as a fiduciary, nor by the Investors as trust beneficiaries. On the contrary, taxpayer reported its income as a partnership. (R. 190.) Indeed, we are at a loss to understand tax-

payer's claim that it was a trust in view of its concurrent claim (Br. 17, 19–20, 26, 28) that the Tax Court erred in refusing to find it was a partnership, At any rate, even assuming, *arguendo,* that the organization was a trust, that would in no wise aid taxpayer's position; the venture would nevertheless fall within the category of business trusts taxable as associations. Section 19.3797–3 of Treasury Regulations 103; *Morrissey* v. *Commissioner, supra; United States* v. *Homecrest Tract,* 160 F. 2d 150 (C. C. A. 9th); *Commissioner* v. *Security-First Nat. Bank,* 148 F. 2d 937 (C. C. A. 9th); *Helm & Smith Syndicate* v. *Commissioner,* 136 F. 2d 440 (C. C. A. 9th); *Kettleman Hills R. S. No. 1* v. *Commissioner,* 116 F. 2d 382 (C. C. A. 9th), certiorari denied, 313 U. S. 582; *Title Insurance & Trust Co.* v. *Commissioner,* 100 F. 2d 482 (C. C. A. 9th); *Sherman* v. *Commissioner,* 146 F. 2d 219 (C. C. A. 6th); *National Metropolitan Bank* v. *Commissioner,* 145 F. 2d 649 (C. C. A. 4th).

Nor is there any basis for taxpayer's contention (Br. 53–62) that the venture was purely a liquidating one, devoid of any profit-seeking business activities. This depends of course on the powers vested in the Operator, and taxpayer may not claim that they were narrower than those set forth in the agreement. *Helvering* v. *Coleman-Gilbert, supra,* p. 374; *Morrissey* v. *Commissioner, supra,* p. 357; *United States* v. *Homecrest Tract, supra; Title Insurance & Trust Co.* v. *Commissioner, supra; Commissioner* v. *Security-First Nat. Bank, supra.* It is crystal clear from the agreement that taxpayer was formed for the purpose of

engaging in profitable business transactions. The Operator was empowered, among other things, to purchase the properties "for the profitable resale thereof" (R. 167–168); to borrow and reborrow money in financing the purchase (R. 167); to "sell, convey, hold, lease for one season only, or in any otherwise deal with and treat said properties as the sole and absolute owner thereof", (R. 168); to "incur such costs, expenses, and charges in connection with the acquiring, holding, renting, selling, or protecting of said properties, as it may deem proper" (R. 168); and it was to make distributions to the Investors "whenever there shall be a net amount of $7,000 or more on hand" (R. 169). Even if only one piece of property were here involved, such broad powers would amply justify treatment of the enterprise as an "association." *Swanson* v. *Commissioner, supra; Helvering* v. *Coleman-Gilbert, supra; Title Insurance & Trust Co.* v. *Commissioner, supra; Wabash Oil & Gas Ass'n* v. *Commissioner,* 160 F. 2d 658 (C. C. A. 1st), certiorari denied, June 9, 1947; *Sherman* v. *Commissioner, supra;* Sections 19.3797–2 and 19.3797–3 of Regulations 103. See also 7A Mertens, Law of Federal Income Taxation, Secs. 43.16, 43.19–43.22. *A fortiori* such conclusion is justified where, as here, the powers relate to 21 separate and widely scattered parcels of real estate, containing over 27,000 acres of diversified properties. Moreover, as the Tax Court noted (R. 222), one of the express purposes of the venture was the "*profitable* resale" of the properties, and there was no time limit within which that purpose was to be

accomplished.[8] What is more, the properties were purchased subject to outstanding leases which yielded a substantial rental income (R. 216), and costly improvements to the property were made by the Operator (R. 218–219). And quite apart from these considerations, the 15 years (1926–1940) of farming, renting, selling, and other activities in which the Operator actually engaged (R. 217–218), and from which the Investors realized almost 100% profit on their investment (R. 218), may hardly be characterized as a merely liquidating venture. *Morrissey* v. *Commissioner, supra; Commissioner* v. *Security-First Nat. Bank, supra; Title Insurance & Trust Co.* v. *Commissioner, supra; Jackson* v. *United States,* 110 F. 2d 574 (C. C. A. 9th); *United States* v. *Trust No. B. I. 35, Etc.,* 107 F. 2d 22 (C. C. A. 9th); *Thrash Lease Trust* v. *Commissioner,* 99 F. 2d 925 (C. C. A. 9th), certiorari denied, 306 U. S. 564; *Kettleman Hills R. S. No. 1* v. *Commissioner,* 116 F. 2d 382 (C. C. A. 9th), certiorari denied, 313 U. S. 582; *United States* v. *Rayburn,* 91 F. 2d 162 (C. C. A. 8th); *United States* v. *Hill,* 142 F. 2d 622 (C. C. A. 10th); *Sherman* v. *Commisioner, supra.* It is immaterial whether, as taxpayer claims (Br. 20–21), the Investors contemplated an *eventual* resale of the properties at a profit; the critical fact remains that the Operator was empowered to hold and deal with the properties indefinitely (R. 168), and did so quite profitably for 15 years (R. 218). It is likewise immaterial whether, as taxpayer claims

[8] In fact, it was never intended that the city property should be subdivided and the Operator refused to sell this property in units of less than one city block. (R. 216–217.)

(Br. 54–55), the depression interferred with the rapidity in which lots were sold. As the Tax Court pointed out (R. 221), even in prosperous times the subdividing and reselling of the extensive acquisitions here involved could not be carried out quickly, and the record shows that it required 5 years to resell the major portion of the properties even when the real estate market was favorable. As this Court stated in *Title Insurance & Trust Co.* v. *Commissioner, supra*, p. 485:

> Petitioner's contention that the trust was not created or maintained for the purpose of carrying on a business disregards the admitted facts. As disclosed by the trust agreement, its purpose was to carry on the business of owning, managing, leasing and selling real property and sharing the gains therefrom. The fact that there was only one piece of property is unimportant. *Swanson* v. *Commissioner,* supra, pages 363, 365, 56 S. Ct. 283. So, also, is the fact that, in the taxable year (1933), the trustee's activities were confined to the collection and distribution of rents, payment of taxes, bookkeeping and other incidental duties. The purpose of the trust is found in the instrument which created it. The parties are not at liberty to say that it had a different or narrower purpose.

If more were needed to demonstrate the weakness of taxpayer's argument it is furnished by the fact that it earned a substantial operating profit as late as the taxable year here involved—most of it from leasing operations. It reported rental income of $48,383.28, and net income of $31,512.01 (R. 190.) Cf. *United*

States v. *Homecrest Tract, supra,* p. 152, fn. 6.[9] To hold, in the face of the record here presented, that taxpayer must as a matter of law be treated as a pure liquidating venture would well nigh render meaningless the statutory mandate that "associations" be classified and taxed as corporations. Certainly the Tax Court applied the correct principles, and its conclusion that the instant organization was an association cannot be said to be without rational basis. Cf. *John Kelley Co.* v. *Commissioner,* 326 U. S. 521; *Dobson* v. *Commissioner,* 320 U. S. 489. Even if this were a border-line case the Tax Court's decision should not be disturbed. *Thrash Lease Trust* v. *Commissioner, supra.*

Taxpayer attempts to draw factual distinctions between this case and some others where the organization was held to be an association (Br. 62–67), and analogies with those where the result was otherwise (Br. 38–45, 53–61). Each case in this field turns, as this Court stated it must (*Thrash Lease Trust* v. *Commissioner, supra*), on its own facts. The decisions are so numerous, and the situations involved so varied, that only the guiding principles stand out. Suffice to note that none of the cases relied upon by taxpayer is comparable on its facts. *Commissioner* v. *Gerstle,* 95 F. 2d 587 (C. C. A. 9th), upon which taxpayer chiefly relies (Br. 46–53), can afford it little comfort. This Court there sustained the Tax Court's conclusion that

[9] Taxpayer's suggestion (Br. 20, 61) that it was not doing business because its business income consisted entirely of capital gains has no basis in fact. And even if true, it would have no relevancy. Cf. *Sherman* v. *Commissioner, supra,* pp. 227–228.

a syndicate was not an "association" since, as the Tax Court had found, (1) the arrangement lacked two of the characteristic advantages of a corporation, namely, limited liability of the participants and ready transferability of their interests (p. 589); and (2) the participants acquired equitable ownership of the syndicate property, not merely personal claims against the syndicate managers (p. 590). The Gerstle syndicate was distinguished by this Court in *Helm & Smith Syndicate* v. *Commissioner, supra* (p. 441), and again in *United States* v. *Homecrest Tract, supra* (p. 153, fn. 7), on the additional ground that it lacked a centralized management. These features serve also to distinguish the *Gerstle* case from the one at hand. As the Tax Court took pains to point out (R. 225–226), the venture here under scrutiny possessed all the salient attributes of a corporation with the possible exception of the limited liability feature, whose absence is not decisive.[10] Furthermore, as is plain from the instant agreement and as the Tax Court observed (R. 224–225), the Investors here did not become co-owners, as did the members of the Gerstle syndicate, but acquired personal claims against the Operator; they had only the right to receive "moneys remaining in the Operator's hands" (R. 169).[11] If any comparison with other cases is to be made, we submit that the organization here involved bears far less resemblance to the Gerstle

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[19] See footnote 5, *supra*.

[11] Even if the Investors had been co-owners, that would not preclude a holding that the organization was an association, rather than a trust or a partnership. See *Helvering* v. *Coleman-Gilbert, supra*, p. 374.

syndicate than to those which were held to be taxable as "associations" in *Wabash Oil & Gas Ass'n* v. *Commissioner, supra,* and *Wellston Hills Syndicate Fund* v. *Commissioner, supra.* See also *Kilgallon* v. *Commissioner,* 96 F. 2d 337 (C. C. A. 7th), certiorari denied, 305 U. S. 622, and *United States* v. *Rayburn,* 91 F. 2d 162 (C. C. A. 8th).

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted.

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October, 1947.

APPENDIX

Internal Revenue Code:

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

(3) *Corporation.*—The term "corporation" includes associations, joint-stock companies, and insurance companies.

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(26 U. S. C. 1940 ed., Sec. 3797.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.3797–1. *Classification of taxables.*—For the purpose of taxation the Internal Revenue Code makes its own classification and prescribes its own standards of classification. Local law is of no importance in this connection. Thus, a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See section 19.3797–3.) The term "partnership" is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called

partnerships. (See section 3797–4.) The term "corporation" is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See sections 19.3797–2 and 19.3797–4.) The definitions, terms, and classifications, as set forth in section 3797, shall have the same respective meaning and scope in these regulations.

SEC. 19.3797–2. *Association.*—The term "association" is not used in the Internal Revenue Code in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a "business" trust, a "Massachusetts" trust, a "common law" trust, an "investment" trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Code, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association.

SEC. 19.3797–3. *Association distinguished from trust.*—The term "trust," as used in the Internal Revenue Code, refers to an ordinary trust, namely, one created by will or by declara-

tion of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

As distinguished from the ordinary trust described in the preceding paragraph there is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries. Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted.

It a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily

joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Internal Revenue Code as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association.

By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as "quasi-corporate form." The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other "officer," the use of a "seal," the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a "charter" or "by-laws," the existence of "control" by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as

outlined above, are attained, in the case of a trust, by the use of the trust form *itself*. The Internal Revenue Code disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed.

SEC. 19.3797–4. *Partnerships.*—The Internal Revenue Code provides its own concept of a partnership. Under the term "partnership" it includes not only a partnership as known at common law but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Code, a trust, estate, or a corporation. On the other hand the Code classifies under the term "corporation" an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or more persons in

their representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also sections 19.3797–2 and 19.3797–3. The following examples will illustrate some phases of these distinctions:

(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Code as a partnership.

(2) A, B, and C contribute $10,000 each for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association.

SEC. 19.3797–5. *Limited partnerships.*—A limited partnership is classified for the purpose of the Internal Revenue Code as an ordinary partnership, or, on the other hand, as an association taxable as a corporation, depending upon its character in certain material respects. If the organization is not interrupted by the death of a general partner or by a change in the ownership of his participating interest, and if the management of its affairs is centralized in one or more persons acting in a representative capacity, it is taxable as a corporation. For want of these essential characteristics, a limited partnership is to be considered as an ordinary partnership notwithstanding other characteristics conferred upon it by local law.

The Uniform Limited Partnership Act has been adopted in several States. A limited partnership organized under the provisions of that Act may be either an association or a partnership depending upon whether or not in the particular case the essential characteristics of an association exist.

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